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SUPERIOR COURT OF THE STATE OF CALIFORNIA

IN AND FOR THE COUNTY OF SAN FRANCISCO

SAN DIEGO COUNTY WATER AUTHORITY,

Petitioner and Plaintiff,

v.

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA; et al.,

Respondents and Defendants.

Case No. CPF-10-510830
Case No. CPF-12-512466

**SAN DIEGO COUNTY WATER AUTHORITY'S OPENING BRIEF DEMONSTRATING THAT SECTION 12.4(c) OF THE EXCHANGE AGREEMENT IS ENFORCEABLE AS A MEASURE OF DAMAGES**

Date: October 15, 2014
Time: 9:00 a.m.
Dept.: 304
Judge: Hon. Curtis E.A. Karnow

Actions Filed: June 11, 2010; June 8, 2012

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## I. INTRODUCTION

The question presented—whether Section 12.4(c) of the parties' Exchange Agreement is enforceable as a measure of damages—is answered by the plain language of that provision:

> In the event of a dispute over the Price, SDCWA shall pay when due the full amount claimed by Metropolitan; provided, however, that, during the pendency of the dispute, Metropolitan shall deposit the difference between the Price asserted by SDCWA and the Price claimed by Metropolitan in a separate interest bearing account. ***If SDCWA prevails in the dispute, Metropolitan shall forthwith pay the disputed amount, plus all interest earned thereon, to SDCWA.*** If Metropolitan prevails in the dispute, Metropolitan may then transfer the disputed amount, plus all interest earned thereon, into any other fund or account of Metropolitan.

Ex. A § 12.4(c) (emphasis added).[1] Met has the burden of proving that this provision is unenforceable pursuant to its express terms—in other words, of proving that somehow it can avoid its obligation to "forthwith pay the disputed amount." *Id.* Met cannot carry that burden.

Putting aside for the moment the law of liquidated damages, which mandates enforcement, § 12.4(c) is reasonable and enforceable according to its terms. Met argues that it would be unreasonable for this Court to enforce § 12.4(c) because Met can conceive various alternate universes where it set different, lawful rates. Met is asking the Court to put the fox back in charge of the henhouse, allowing Met to concoct made-for-litigation rates in order to keep some (if not all) of the "disputed amount" it set aside pursuant to § 12.4(c). But this is not how refunds for unlawful rates work, even in ordinary mandamus actions ***without*** an explicit contractual payout provision like § 12.4(c).[2] An agency that imposes unlawful rates or charges cannot avoid paying a full refund by arguing for a partial refund based on material not included in its administrative record. *See Cresta Bella, LP v. Poway Unified Sch. Dist.*, 218 Cal. App. 4th 438, 453 (2013); *Warmington Old Town Assocs., L.P. v. Tustin Unified Sch. Dist.*, 101 Cal. App. 4th 840, 867 (2002). Here, as Met admits, "there is no evidence in the record as to the rate or rates that MWD's Board would or could have properly set under the Exchange Agreement and consistent with the Statement of Decision." Met's July 30, 2014 Consolidated Reply ISO Mots.

[1] Exhibit references are to the Declaration of Dan Jackson, filed herewith.

[2] San Diego has reserved—and hereby continues to reserve—its right to seek a refund in connection with its administrative rate claims, depending on the outcome of its contract claims.

to Amend & Reopen Discovery ("Met's Disco. Reply") at 10:14-16. Holding Met to its promise to "forthwith pay the disputed amount" is the only reasonable outcome here. Ex. A § 12.4(c).

The law of liquidated damages also requires Met to pay the disputed amount "forthwith." *Id.* Again, the burden is on Met to prove that § 12.4(c) is unreasonable and unenforceable as a liquidated damages provision, but Met's arguments prove the opposite. Met admits that damages were difficult or impossible to evaluate at the time of contracting, and that any proceeding to determine them now in court would not only be difficult but, according to Met, would violate the constitutional separation of powers. It was perfectly reasonable for the parties to agree at the outset to forego a difficult, uncertain, and—in Met's view—unlawful damages phase in favor of the simple procedure set forth in § 12.4(c). Likewise, the only reasonable path forward now is for the Court to enforce Met's promise. Met must "forthwith pay the disputed amount." *Id.*

## II. BACKGROUND

As San Diego explained in detail in its pretrial brief, the 2003 Exchange Agreement temporarily tabled the parties' disputes over Met's rates in order to facilitate the transfer of conserved water from the Imperial Valley to San Diego, which was essential to California's efforts to curtail its overuse of Colorado River water. *See* San Diego's First Pretrial Br. at 4-19 (Oct. 18, 2013). Under the Exchange Agreement, Met obtains the water to which San Diego is entitled under its agreements with the Imperial Irrigation District ("IID"), and delivers to San Diego a like quantity of "Exchange Water" for a "Price," which "shall be equal to the charge or charges set by Metropolitan's Board of Directors pursuant to applicable law and regulation and generally applicable to the conveyance of water by Metropolitan on behalf of its member agencies." Ex. A § 5.2. The Price Met charges San Diego under the Exchange Agreement consists of the System Access Rate ("SAR"), System Power Rate ("SPR"), and Water Stewardship Rate ("WSR")—collectively the "transportation rates." *See*, *e.g.*, Ex. B.

Section 12.4(c), quoted in full above, provides that if San Diego prevails in a dispute over the Price (after an agreed five-year litigation ceasefire), Met "shall forthwith pay the disputed amount, plus all interest earned thereon," to San Diego. Ex. A § 12.4(c). After the trial in December of last year and this Court's subsequent Statement of Decision, San Diego has

prevailed in the dispute over the validity of the rates that constitute the Price under the Exchange Agreement—the SAR, SPR, and WSR. This Court invalidated these transportation rates because they violate applicable law by misallocating the costs of the State Water Project ("SWP") and the costs of conservation and local water supply development programs funded by the WSR. *See* Statement of Decision (Apr. 24, 2014) ("SOD") at 65; *see also id.* at 2 ("I find for San Diego on [these] two issues.…").[3] As discussed below, these two issues on which the Court found for San Diego are exactly those on which the § 12.4(c) "disputed amount" at issue here is based.

The meaning of § 12.4(c)—that Met "shall forthwith pay the disputed amount"—is plain on its face, and the extrinsic evidence is consistent with the plain meaning. Perhaps the most telling extrinsic evidence comes from Met's statements to its bondholders, in which it must abandon its litigious posturing vis-à-vis San Diego in favor of speaking more honestly to its investors. *See, e.g.*, Ex. C at A-48-49. On June 19, 2013, for example, Met told its investors that it was holding $84.4 million pursuant to § 12.4(c). *Id.* "Amounts held pursuant to the exchange agreement will continue to accumulate based on the quantities of exchange water that Metropolitan provides to SDCWA and the amount of charges disputed by SDCWA. ***These amounts are transferable to SDCWA if it prevails in the litigation***." *Id.* (emphasis added).

The parties' correspondence about § 12.4(c) further demonstrates that they understood it to be an enforceable damages provision. On February 10, 2011, San Diego's General Counsel wrote to Met's General Manager and General Counsel, specifically referencing § 12.4(c); providing a calculation of an overcharge of $236 per acre-foot of water transported under the Exchange Agreement; and demanding that Met place that amount into a separate interest-bearing account. Ex. D. The disputed overcharge was the result of Met's improper inclusion of SWP costs and the WSR in its transportation rates constituting the Price under the Exchange Agreement—the same disputes on which San Diego has now prevailed. *See id.*; SOD at 1-2, 65.

On February 24, 2011, Met's General Counsel confirmed that Met was complying with § 12.4(c) by placing $236 per acre foot in an interest-bearing account. Ex. E. Met did not,

[3] The Court found for Met on the "dry-year peaking" issue, but that is irrelevant here because that issue has never factored into the "disputed amount" under § 12.4(c). *See* Exs. D & I.

however, simply adopt San Diego's calculation of the total "disputed amount." Instead, Met advised San Diego that it would "calculate the amount of payments under protest based upon the amounts of Colorado River water approved by the Bureau of Reclamation for … exchange with the Water Authority." *Id.* Met did not argue—and, at least until this Court invalidated Met's rates, has never argued—that $236 per acre foot of that water was not the proper "disputed amount" under § 12.4(c); nor did Met argue that § 12.4(c) is unenforceable. *See id.*

On October 2, 2012, San Diego's new Treasurer requested information about the interest-bearing account. Ex. F. Met responded that the account balance was $57.4 million as of September 30, 2012. Ex. G. Again, Met did not challenge the disputed amount or the enforceability of § 12.4(c). *See id.* On the contrary, Met confirmed once again that "the amounts that are in dispute are being set aside in a separate account," with interest. *Id.*

On February 5, 2013, a month after Met's rates for 2013 and 2014 went into effect, San Diego's General Counsel demanded, pursuant to § 12.4(c), that Met set aside the "disputed amount," defining that term to include San Diego's payments of the then-new SAR, SPR, and WSR rates under the Exchange Agreement. *See* Ex. H. Met responded on February 25, 2013, promising to deposit what ***Met contended*** to be the disputed amount, but refusing to set aside the entire amount San Diego had defined as the "disputed amount" based on the new rates. *See* Ex. I. Instead, Met determined that it would continue to set aside as the "disputed amount" $236 per acre-foot, based on the old rates. *Id.* Met also disavowed its current litigation interpretation of the disputed amount as merely a security deposit, contending instead that Met "is under no obligation to refrain from using the funds in this account." *Id.*

Brian Thomas, Met's chief negotiator of the Exchange Agreement, admitted that Met agreed to "forthwith pay the disputed amount," just as § 12.4(c) says:

> Q. And if the Water Authority prevails in the price dispute, then what happens?
>
> A. That amount that they prevail on would be given to the Water Authority along with all interest earned.
>
> Q. And that's what Metropolitan agreed to, that requirement?
>
> A. Yes.
>
> Q. And the term "Metropolitan shall forthwith pay the disputed amount," that's … a mandatory obligation, right?

A. Yeah, that's what we agreed to.

Ex. J (Thomas Dep.) at 155:19-156:9. Mr. Thomas subsequently attempted to characterize the disputed amount as a mere security deposit, "so Met couldn't spend it on other things." *Id.* at 157:10. But that is a litigation invention that is irreconcilable with Met's own correspondence asserting that it "is under no obligation to refrain from using the funds in this account." Ex. I. Mr. Thomas also interpreted "Metropolitan shall forthwith pay the disputed amount" to mean that it will pay "the portion of the disputed amount on which [San Diego] prevails." Ex. J at 157:19-158:11. Even under that interpretation, however, now that San Diego has prevailed in both disputes on which the "disputed amount" is based—Met's misallocation of SWP and WSR costs—Met must "forthwith pay the disputed amount." Ex. A § 12.4(c). Section 12.4(c) plainly obviates the need for further litigation, after San Diego has prevailed in the dispute, to determine the "portion" of the "disputed amount" San Diego will receive in light of hypothetical, judicially-supervised ratemaking that, according to Met, would violate the separation of powers. *See id.*

The testimony of Scott Slater, San Diego's chief negotiator, further confirms that the parties intended § 12.4(c) to be an enforceable measure of damages. Mr. Slater testified that § 12.4(c) "is an articulation of the damage due." Ex. K (Slater Dep.) at 147:7. Asked whether it is a liquidated damage clause, Mr. Slater testified that "I guess you could characterize it as a liquidated damage provision since there are no other damages available." *Id.* at 147:17-19. Pressed again about whether there is "[a]nything similar to the nomenclature of liquidated damages," Mr. Slater testified: "You get your money back. Right?" *Id.* at 148:25-149:2. Right.

## III. ARGUMENT

### A. Section 12.4(c) is reasonable and must be enforced according to its terms.

Although Met argued before, and presumably will argue again, that § 12.4(c) is not a liquidated damages clause, it is important to note at the outset that the enforceability of § 12.4(c) does not depend on nomenclature. The law of liquidated damages is a well-worn path that this Court may follow, as discussed below. But § 12.4(c) can and should be enforced on its own terms, regardless of its status as a liquidated damages provision.

For example, in *Chanan Singh v. Cross*, 60 Cal. App. 309 (1922), the parties agreed that,

in the event of a breach, the defendants would pay the plaintiffs' costs, plus 10%. *Id.* at 318. The defendants tried to avoid paying by arguing that these damages were not "liquidated," but the court found it "immaterial … whether the provision be sustained as one for liquidated damages or as a provision granting to the plaintiffs an option. The provision is one that will be enforced by the courts, the plaintiffs have relied upon it, and have recovered thereunder." *Id.* at 319.

Met's argument that § 12.4(c) is not a liquidated damages provision is also "immaterial." *Id.* Section 12.4(c) is enforceable, whether as a liquidated damages provision or a sui generis damages clause tailored for the unique circumstances of this Exchange Agreement between two public utilities. Either way, it is a reasonable provision the parties bargained for in light of the relevant circumstances, including the complexity of rate setting; and both parties have relied on it. *See id.* Met has already received the benefits for which it bargained. San Diego has paid "the full amount [Met] claimed" based on Met's unlawful rates, and Met will keep ***all*** of the tens of millions of dollars San Diego overpaid under the Exchange Agreement during the five-year hiatus on rate disputes, before the "disputed amount" began to be set aside. *See* Ex. A §§ 12.4(c), 5.2, 11.1. Yet now, Met seeks to deprive San Diego of the benefit of its bargain—Met's payment of the disputed amount "forthwith." *Id.* § 12.4(c).

Met's attempt to evade its obligations under § 12.4(c) boils down to the assertion that the amount of damages is unreasonable because, had Met established valid rates in the first place, San Diego might have been required to pay some portion of the "disputed amount." But the courts have rejected this line of argument even in ordinary mandamus actions; it must fail a fortiori given § 12.4(c). For example, in *Cresta Bella*, the defendant school district improperly charged for the entire square footage of a development project that replaced existing apartments, rather than limiting its charges to the increase over the preexisting square footage. Most importantly for present purposes, the court rejected the argument that a full refund of the charges for preexisting square footage was inappropriate because the school district might be able to come up with a valid justification for those charges, given another chance:

> There may be circumstances in a particular school district's housing reconstruction trends that could support a correlation between reconstruction of preexisting residential units and the generation of new students; however, ***it is not contained***

> ***in the [administrative record] under consideration in this case. Thus, the District did not carry its burden … and Cresta Bella is entitled to a refund for the fees imposed on the preexisting square footage in its project.***

218 Cal. App. 4th at 453 (emphasis added).

*Cresta Bella* followed *Warmington*, where the court granted "the ***entire*** refund" because the administrative record did not contain "enough information … to determine the amount of … a ***partial*** refund." 101 Cal. App. 4th at 867 (emphases added). And both *Cresta Bella* and *Warmington* followed *Shapell Industries, Inc. v. Governing Board*, 1 Cal. App. 4th 218 (1991), where the court rejected the argument—which Met recycles here—"that the principle of separation of powers demands that the matter be returned to [the agency] to determine the lawful and unlawful portions of the fee," which is "precisely the task which was delegated to the [agency] in the first instance and which it failed to perform." *Id.* at 244. The amount of any partial refund "must be determined, if possible, on the basis of the evidence before the Board at the time." *Id.* But where, as here, the agency failed to include evidence in its administrative record clearly establishing the amount of a partial refund, the result is not, as Met contends, that the plaintiff either receives no refund at all or must return to the henhouse to ask the fox for reparations, but that ***the plaintiff receives the entire disputed amount***. *See id.*; *Cresta Bella*, 218 Cal. App. 4th at 453; *Warmington*, 101 Cal. App. 4th at 867; Met's Disco. Reply at 10:14-16.

These authorities make clear that it was perfectly reasonable for the parties here to agree from the beginning that "[i]f SDCWA prevails in the dispute, Metropolitan shall forthwith pay the disputed amount, plus all interest earned thereon, to SDCWA." Ex. A § 12.4(c). That would be a completely appropriate result even without a contract, given Met's admitted failure to include in its administrative record any valid basis for paying San Diego less than the disputed amount. *See Cresta Bella*, 218 Cal. App. 4th at 453; *Warmington*, 101 Cal. App. 4th at 867; Met's Disco. Reply at 10:14-16. It is also common in other contexts to award the entire disputed amount to the prevailing party. *See, e.g., Bowers v. Raymond J. Lucia Cos., Inc.*, 206 Cal. App. 4th 724, 731-37 (2012) (upholding an agreement "requiring the mediator to pick either plaintiffs' demand or defendant's offer," as in "baseball arbitration"). Having taken an all-or-nothing approach all along, Met cannot complain now about being held to its express promise to "forthwith pay the

disputed amount." Ex. A § 12.4(c). Nor can Met dispute that San Diego "prevail[ed]." *Id.* Under the Exchange Agreement and as a matter of administrative law, San Diego was not required to prove what lawful rates would have been; only that Met failed to set lawful rates, which is exactly what this Court has held. *See* Ex. A §§ 5.2, 11.1, 12.4(c); *Cresta Bella*, 218 Cal. App. 4th at 453; *Warmington*, 101 Cal. App. 4th at 867; SOD.

Thus, this Court should enforce § 12.4(c) on its own terms as a damages provision.

**B. Section 12.4(c) is enforceable under the law of liquidated damages.**

The law of liquidated damages further compels the conclusion that § 12.4(c) is enforceable as a measure of damages. In 1978, the California legislature reversed the formerly "strict attitude toward liquidated damage clauses," agreeing with its Law Revision Commission "that liquidated damages provisions are useful and should be encouraged." 1 B.E. WITKIN, SUMMARY OF CALIFORNIA LAW, CONTRACTS § 533 (10th ed. 2014) (Ex. M). Among other benefits, liquidated damages enable parties to "avoid the cost, difficulty, and delay of proving damages, and eliminate the issues of causation and foreseeability"; they establish an "incentive to perform" that one of the parties may otherwise lack; and they "may improve judicial administration and conserve judicial resources because of fewer contract breaches, fewer lawsuits, and less extended trials." *Id.* (citing 13 Cal. Law Rev. Com. Reports 1740, 1741).

As amended, the law provides that (except for consumer contracts) "a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made." Cal. Civ. Code § 1671(b). Parties now have "considerable leeway in determining the damages for breach." Cal. Law Revision Com. cmt. (Ex. N). For example, a "liquidated damages provision is not invalid merely because it is intended to encourage a party to perform, so long as it represents a reasonable attempt to anticipate the losses to be suffered." *Weber, Lipshie & Co. v. Christian*, 52 Cal. App. 4th 645, 656 (1997).

The burden of proof is on the party seeking to invalidate a liquidated damages provision. *See Weber*, 52 Cal. App. 4th at 654; Cal. Law Revision Com. cmt. to § 1671.[4] Factors for the

[4] In its prior briefing on § 12.4(c), Met cited pre-amendment cases and *UCAN v. AT&T*, 135 Cal.

Court to consider in deciding whether Met has carried its burden include "the relationship that the damages provided in the contract bear to the range of harm that reasonably could be anticipated at the time of the making of the contract"; the parties' anticipation "that proof of actual damages would be costly or inconvenient"; and "the difficulty of proving causation and foreseeability." Cal. Law Revision Com. cmt. to § 1671. These factors strongly favor enforcement of § 12.4(c) as a measure of damages.[5] Met cannot carry its burden of proving otherwise.

Section 12.4(c)'s "disputed amount" not only bears a reasonable relationship to the range of harms**,** it is expressly defined by that range, as determined in good faith by the parties: "the difference between the Price asserted by SDCWA and the Price claimed by Metropolitan." Ex. A § 12.4(c). As discussed above, this provision simply—and quite reasonably—mandates in advance the result that should follow from Met's admitted failure to establish in its administrative record any basis for paying San Diego anything less than the disputed amount. *See Cresta Bella*, 218 Cal. App. 4th at 453; *Warmington*, 101 Cal. App. 4th at 867; Met's Disco. Reply at 10:14-16.

Indeed, the § 12.4(c) "disputed amount" is more closely related to the range of potential damages than liquidated damages provisions upheld by the courts even before Civil Code § 1671 was amended. For example, in the seminal case *Dyer Bros. Golden West Iron Works v. Central Iron Works*, 182 Cal. 588 (1920), the provision at issue required that each member of a cooperative "pay into a common fund a sum of money … to be determined by the gross annual business of the party making such payment," which would be distributed upon termination of the

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App. 4th 1023 (2006), for the proposition that the party seeking liquidated damages must plead them. *See* Met's Disco. Reply at 6. But *UCAN* involved consumer contracts and thus was "a continuation of prior law on the subject." 135 Cal. App. 4th at 1029. Because the Exchange Agreement is not a consumer contract, the applicable law here is ***not*** "a continuation of prior law," *id.*, but instead, quoting another of Met's cases, departs "***radically*** from the former law." *ABI, Inc. v. L.A.*, 153 Cal. App. 3d 669, 684 (1984) (emphasis added).

[5] In addition to these substantive factors, the Commission listed the parties' relative bargaining power; whether they were represented by counsel; and whether the agreement is a form contract. *See* Cal. Law Revision Com. cmt. to § 1671. These procedural factors also favor enforcement of § 12.4(c). If either party had more bargaining power, it was Met, which controls the only means of getting water from the Imperial Valley to San Diego and, as it often points out, has the power to set rates. Both parties were represented by counsel, and Met's outside counsel drafted the Exchange Agreement, which—far from being a form contract—is a special-purpose contract between two sophisticated public agencies that had been in negotiations and litigation for years. *See* Ex. J (Thomas Dep.) at 38:20-42:6; *Met v. IID*, 80 Cal. App. 4th 1403 (2000).

contract "among the parties who had kept the covenants and conditions." *Id.* at 590. The plaintiffs alleged that the defendants breached the contract and thus should be ordered to pay their deposits to the plaintiffs. *See id.* The defendants demurred, arguing that this was an unenforceable penalty, but the California Supreme Court disagreed:

> The sums to be paid for a noncompliance in this regard were not uniform amounts arbitrarily determined, but were to be based upon the gross business transacted by the respective parties, evidently upon the theory that the loss to those continuing to observe the terms of the contract depended in a considerable measure upon the volume of business of the party ceasing to act in unison with the remaining parties. The contract is thus clearly distinguishable from that class of contracts in which an arbitrary sum is to be paid.…

*Id.* at 592. Section 12.4(c) is more than reasonable under *Dyer*; the amendment of § 1671 and subsequent cases only reinforce that conclusion. *See, e.g.*, *Weber*, 52 Cal. App. 4th at 653-57.

Met's own contentions in the brief it filed at the end of July further confirm that § 12.4(c) is reasonable and enforceable as a measure of damages. According to Met:

> Here, as of October 2003 when the contract was formed, the parties did not know, nor could they know, how much the price charged in the future might differ from a "lawful rate." The parties could not know future costs nor foresee how they might be allocated. Any amount of liquidated damages could not be reasonably related to actual damages because the range of actual damages was unknown and unknowable.

Met's Disco. Reply at 9:4-8. Met has the factual premise right, but its legal conclusion is completely wrong. California courts have long recognized that "***the greater the difficulty encountered by the parties in estimating damages which might arise from a breach, the greater should be the range of estimates which the courts should uphold as reasonable***." *Better Food Mkt. v. Am. Dist. Tel. Co.*, 40 Cal. 2d 179, 187 (1953) (emphasis added); *accord Atkinson v. Pac. Fire Extinguisher Co.*, 40 Cal. 2d 192, 197 (1953); *Lowe v. Mass. Mut. Life Ins. Co.*, 54 Cal. App. 3d 718, 737 (1976). In other words, the Court should uphold § 12.4(c) as a reasonable measure of damages ***precisely because*** the range of actual damages was admittedly "unknown and unknowable" at the time the contract was made. Met's Disco. Reply at 9:8.

Particularly under the law as amended, courts only refuse to enforce liquidated damages provisions that are truly arbitrary—*i.e.*, where the lack of a logical relationship between the liquidated amount and the potential harm is clear a priori. *Cf. Dyer*, 182 Cal. 592-93 (upholding, even under prior law, a liquidated damages clause that was not "arbitrary"). For example, in *ABI,*

on which Met relies, the fee at issue was not reasonably related to potential damages because it did not require any breach at all by the party to be charged. *See ABI*, 153 Cal. App. 3d at 684-85. Likewise, in *Ridgley v. Topa Thrift & Loan Ass'n*, 17 Cal. 4th 970 (1998), the charge at issue was "logically unrelated" to the breach because, while it was supposedly a fee for prepayment of a loan, it was imposed for late payment of interest, which had nothing to do with prepayment. *Id.* at 981. While Met cites *Ridgley* for the proposition that contracting parties "must compare two amounts, *i.e.* the liquidated amount with the range of actual damages," Met's Disco. Reply at 9:3-4, the Court in *Ridgley* simply held that liquidated damages must bear a "reasonable relationship to the range of actual damages that the parties ***could have anticipated***." 17 Cal. 4th at 977 (emphasis added). *Ridgley* did not hold that parties must "compare" actual and liquidated damages where, as here, it was admittedly impossible to do so when the contract was formed. That would defeat the very purpose of liquidated damages. *See, e.g., Atkinson*, 40 Cal. 2d at 197.

Moreover, even before Civil Code § 1671 was amended, the California Supreme Court held that "no actual damage is necessary in order to recover under a liquidated damages provision." *McCarthy v. Tally*, 46 Cal. 2d 577, 586 (1956). After the amendment, actual damages are not only unnecessary, but ***irrelevant***. "The validity of the liquidated damages provision depends upon its reasonableness at the time the contract was made and not as it appears in retrospect. Accordingly, ***the amount of damages actually suffered has no bearing on the validity of the liquidated damages provision***." Cal. Law Revision Com. cmt. to § 1671 (emphasis added). San Diego has indisputably suffered actual damages. As this Court held, Met has over-collected on the rates it charges San Diego as the Exchange Agreement Price "because at least a significant portion of these [SWP and WSR] costs are attributable to supply, not transportation." SOD at 65. But Met's contention that the exact amount of San Diego's actual damages must be determined and compared with the "disputed amount" is clearly incorrect given that San Diego could recover liquidated damages under § 12.4(c) without ***any*** actual damages, which have "no bearing" on the validity of § 12.4(c). Cal. Law Revision Com. cmt. to § 1671.

Met criticizes San Diego because it "*never accounted for the amount it would have paid under lawful rates.*" Met's Disco. Reply at 9 n.6 (Met's emphasis). Yet Met acknowledges that

San Diego could not have done so because "there are numerous options for replacement rates." *Id.* In any event, Met is wrong to assert that "it is undisputed that the measure of actual damages would be the difference between what SDCWA paid and the amount it would have paid if the rates had been set lawfully"—including what San Diego might have paid for ***Met*** water, as opposed to the transportation of ***IID*** water, which is what the Exchange Agreement is about. Met's Disco. Reply at 9 n.6. Contract damages are defined as the benefit of the parties' bargain. *See, e.g., Honey v. Henry's Franchise Leasing Corp. of Am.*, 64 Cal. 2d 801, 803 (1966). That bargain did not require San Diego—which was denied access to Met's rate model—to engage in an indeterminate and contentious analysis of how charges for ***Met*** water ***might*** have changed given San Diego's asserted Price for transportation of ***IID*** water under the Exchange Agreement. *See* Ex. A § 12.4(c); Ex. D. On the contrary, inquiry into such extra-contractual eventualities would be improper because Met did not put the relevant information into its administrative record, *see Shapell*, 1 Cal. App. 4th at 244, and is unnecessary because the parties agreed to forego speculation about alternative rates by "mutually agree[ing] to a different assignment of risk via an indemnification/liquidated damages clause." *Radisson Hotels Int'l, Inc. v. Majestic Towers, Inc.*, 488 F. Supp. 2d 953, 963 (C. D. Cal. 2007).

Met's prior brief is itself a compelling demonstration of why it was more than reasonable for the parties to agree that the prevailing party would be entitled to the disputed amount "forthwith," rather than requiring a complicated analysis of the "numerous options for replacement rates." Met's Disco. Reply at 9 n.6. As Met admits, "there is no evidence in the record as to the rate or rates that MWD's Board would or could have properly set under the Exchange Agreement and consistent with the Statement of Decision." *Id.* at 10:14-16. Met proposes to cure that defect by conducting further expert discovery; asking this Court to sort it all out at trial; and then asking the Court of Appeal to overturn any unfavorable result as a violation of the separation of powers. *See generally id.* Again, however, the court in *Shapell* rejected the argument that an agency found to have imposed invalid rates may conduct an iterative process of record making to arrive at the lowest permissible refund. *Shapell*, 1 Cal. App. 4th at 244; *see also Cresta Bella*, 218 Cal. App. 4th at 453; *Warmington*, 101 Cal. App. 4th at 867. Even if *Shapell*

and its progeny did not preclude Met from taking multiple bites at the rate-making apple, which they do, the parties had good reason to avoid that messy situation by agreeing to § 12.4(c) instead. From San Diego's perspective, it would be a pyrrhic victory to invalidate Met's rates, but then be forced to play a game of "how about these rates?" in a damages phase where Met's stated goal is to asymptotically approach "*no* damages." Met's Disco. Reply at 9 n.6.

Met also benefits from § 12.4(c), though it pretends otherwise now that San Diego has prevailed. Not only did § 12.4(c) guarantee Met prompt and full payment of its unlawful rates pending invalidation, and allow Met to keep at least five years of full payments despite the rates' invalidity, § 12.4(c) also cabins damages to Price disputes over Exchange Water. If, despite § 12.4(c), the Court must consider alternate hypothetical scenarios in which Met set valid rates, the result, contrary to Met's assumption, may be damages ***greater*** than the "disputed amount," particularly because Met would have to pay San Diego's consequential damages. For example, if Met had imposed valid rates, San Diego would not have filed this action, and would not have been banned, under Met's Rate Structure Integrity clause, from receiving the subsidies for conservation and local water supply development that Met funds through its WSR. By Met's hypothesis that one must look beyond the Exchange Agreement and the administrative record to consider what ***might*** have happened, there is indeed no way of knowing the amount of money that San Diego might have received. In any case, there should be no assumption in this alternate reality that the amount San Diego might have received would be limited to the WSR payments it made under the Exchange Agreement and included in the "disputed amount." San Diego—like some other agencies—***might*** have gotten more money back than its total WSR payments for Exchange Water and Met water combined. *See* Ex. L at 23. In short, for both parties—and this Court—speculative, counterfactual ratemaking leads to madness, so the parties tied themselves to the mast with § 12.4(c). Met's pleas to be released should fall on deaf ears, just as Ulysses's did.

Met argues that § 12.4(c) is unreasonable as a measure of damages because San Diego supposedly could "inflate its claim" by asserting, for example, that $150 million is in dispute based on an overcharge of only $1 million. Met's Disco. Reply at 10:2-8. But the law independently prevents San Diego from doing that. *See, e.g., Foley v. Interactive Data Corp.*, 47

Cal. 3d 654, 683 (1988) ("'Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.'") (quoting Rest. 2d Contracts § 205). The fact that Met can imagine—but does not and cannot assert—such a breach of the covenant of good faith and fair dealing does not make § 12.4(c) unenforceable. *See, e.g., XCO Int'l Inc. v. Pac. Scientific Co.*, 369 F.3d 998, 1005 (7th Cir. 2004) (Posner, J.) ("[T]he proper judicial remedy would be to reform the [liquidated damages] clause to limit it to those breaches, such as the one that occurred in this case, for which it constituted a reasonable specification of damages. There would be no reason to invalidate the clause in its entirety.").

The § 12.4(c) "disputed amount" is based on the issues on which San Diego prevailed, and Met never contested the reasonableness of the amounts it set aside. To the extent Met disagreed with San Diego's calculations, it made its own, and set aside the "disputed amount" accordingly. Indeed, far from contending that the "disputed amount" was unreasonable, or an improper measure of damages, Met informed its investors that "***[t]hese amounts are transferable to SDCWA if it prevails in the litigation***." Ex. C at A-49 (emphasis added).

Furthermore, while Met made whatever adjustments it deemed necessary to the "disputed amount" San Diego calculated, San Diego had no such control over Met's rates, which are the primary determinant of the "disputed amount." To the extent anything here can be characterized as "unilateral," it is Met's conduct, not San Diego's. *Cf.* Met's Disco. Reply at 1. And, in any event, the courts have rejected the argument that the law requires "both parties … to expressly negotiate the amount of liquidated damages." *UCAN*, 135 Cal. App. 4th at 1035; *see Lowe*, 54 Cal. App. 3d at 735-36 (holding that "parties [need] not discuss the possible actual damages").

Met also argues that § 12.4(c) does not provide for liquidated damages because the damages are not sufficiently "fixed." *See* Met's Disco. Reply at 3-4. But this contradicts Met's own suggestion that § 12.4(c) would be unenforceable if the damages it provides ***were*** "fixed." *Id.* at 9 (citing *Smith v. Royal Mfg. Co.*, 185 Cal. App. 2d 315, 323-24 (1960)). And Met is wrong in any case, as its own cases make clear. Damages may be liquidated even if they are not fixed in the contract itself as long as ascertaining the amount to be paid does not require "'judicial determination based on conflicting evidence.'" *Chodos v. West Publ'g Co.*, 292 F.3d 992, 1002

n.11 (9th Cir. 2002) (quoting *Leaf v. Phil Rauch, Inc.*, 47 Cal. App. 3d 371 (1975)). Here, the "disputed amount" is certain—Met sets it out with specificity in its own Bond Statements, for example—and does not require judicial determination.[6]

Finally, Met argues that § 12.4(c) is merely a contractual provision for a security deposit, rather than a measure of damages. *See* Met's Disco. Reply at 8:1-9. Leaving aside that Met itself has ***denied*** that § 12.4(c) provides for a security deposit, *see* Ex. I, the Law Revision Commission comments on which Met relies make clear that even if the "disputed amount" is a deposit, this is in no way inconsistent with it also being a measure of damages. On the contrary, the amount set aside may be both a deposit and liquidated damages, unless the parties agree that "the deposit is ***merely*** a fund to secure the payment of ***actual damages if any are determined***." Cal. Law Revision Com. cmt. to § 1671 (emphases added). The parties here specified the ***opposite***: Met must "***forthwith*** pay the ***disputed amount***." Ex. A § 12.4(c) (emphases added). This clear language is really all that matters. Although Met argues that the parties' intentions are paramount, and makes much of the fact that they did not use the term "liquidated damages," what is relevant is the "'legal intent' that would be imputed to the parties based on the language used, and not their actual intention at the time of contracting." *UCAN*, 135 Cal. App. 4th at 1034; *see also Dyer*, 182 Cal. at 592 (whether the parties use the words "penalty" or "liquidated damages" is "by no means controlling"). Here, the clearly expressed legal intent is that Met must "forthwith pay the disputed amount." Ex. A § 12.4(c).

## IV. CONCLUSION

Accordingly, this Court should enforce § 12.4(c) as a damages provision.

Dated: September 12, 2014

KEKER & VAN NEST LLP

*/s/ Dan Jackson*

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SAN DIEGO COUNTY WATER AUTHORITY

[6] Met also suggests that the court in *ABI* denied liquidated damages because they were not fixed. *See* Met's Disco Reply at 3. But *ABI*'s holding, which Met strategically elides from its quotation, was that the clause at issue did not provide for liquidated damages because it did not require "*breach of some contractual obligation.*" *ABI*, 153 Cal. App. 3d at 685 (emphasis in original).

**PROOF OF SERVICE BY ELECTRONIC TRANSMISSION AND EMAIL VIA PDF FILE**

I am employed in the City and County of San Francisco, State of California in the office of a member of the bar of this court at whose direction the following service was made. I am over the age of eighteen years and not a party to the within action. My business address is Keker & Van Nest LLP, 633 Battery Street, San Francisco, CA 94111-1809.

On September 12, 2014, I served the following documents described as:

**SAN DIEGO COUNTY WATER AUTHORITY'S OPENING BRIEF DEMONSTRATING THAT SECTION 12.4(c) OF THE EXCHANGE AGREEMENT IS ENFORCEABLE AS A MEASURE OF DAMAGES**

by serving a true copy of the above-described documents in the following manner:

**BY LEXIS NEXIS® FILE & SERVE**

On the date executed below, I electronically served the documents described above via Lexis Nexis® File & Serve on the recipients designated on the Transaction Receipt located on the via Lexis Nexis® File & Serve website.

Executed on September 12, 2014, at San Francisco, California.

I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Maria Canales